CHIN TECK PLANTATIONS BHD.

v.

KETUA PENGARAH HASIL DALAM NEGERI

FEDERAL COURT, KUALA LUMPUR
RAJA AZLAN SHAH CJ (MALAYA)
ABDUL HAMID OMAR FJ
EUSOFFE ABDOOLCADER J
[CIVIL APPEAL NO. 137 OF 1980]
3 JULY 1981

REVENUE LAW: *Income Tax - Gain from sale of proprietory rights in timber - Whether capital assets or an adventure in the nature of trade - Whether gain derived from the transaction is capital receipt or revenue receipt - Whether sums paid by taxpayer to permit holder deductible - Construction of s. 39(1)(g) Income Tax Act 1967.*

The appellant was a trading company incorporated as a public company in 1968 with the object, *inter alia*, to carry on business of planters of agricultural produce, cultivation, buying rubber, working and dealing with timber.

An association of the appellant company called NS Oil Palm Bhd. entered into two agreements with the late Sultan of Pahang and a third agreement with his successor, DYMM Tengku Ahmad Shah, the present Sultan. The first agreement dated 5 March 1973 was for the purpose of a piece of land containing an area of approximately 10,000 acres in Keratong. Under the second agreement dated 11 June 1973, it was agreed that the land would be transferred directly to the appellant on issue the of the title deed by the Government. Under the third agreement dated 12 January 1975 the present Sultan agreed to comply with the terms of the earlier agreements executed by his late father and to facilitate in the issue of two forest licences (i) the KSK (Kawasan Sudah Kerja) licence covering an area of 6,976 acres to enable the appellant to carry out extraction of logs and to retain the proceeds of sale and (ii) another licence for the remaining area of 3024 acres of virgin forest also to enable the appellant to extract logs therefrom within a period of 2-3 years but the licences were never issued to the appellant. The licence in respect of the 6,976 acres was however issued to the present Sultan on 1 July 1976. The present Sultan and Tengku Abdullah were issued with a qualified title as representatives for the land containing an area of approximately 10,000 acres on a 99 year lease wef 19 April 1976, subject to the condition that the land must first be cleared of all timber within the stipulated period and with the written approval of the state Forest Officer, Pahang and to be planted with oil palms.

Under the three agreements the appellant purchased 10,000 acres of jungle land with valuable timber for a total consideration of RM1,800,000 and he became the registered owner on 2 July 1976. The appellant did not itself extract the logs but sold them for a sum of RM540,000 to Koh Tong Leong Sdn. Bhd., under a sale agreement dated 16 June 1975 who were to cut and remove all the logs at their expense.

The appellant was assessed with income tax in respect of the RM540,000 proceeds of the sale of timber logs in the 6,976 KSK area. On appeal before the special commissioners, they found that the proceeds of sale were gains derived from an adventure in the nature of trade and therefore assessable, as the dominant purpose of the appellant's purchase of land was to sell timber and to plant oil palms. On an appeal to the High Court, the learned Judge Salleh Abbas FJ accepted the special commissioner's finding.

The appellant appealed to the Federal Court on the grounds that the learned Judge had erred in law in holding:

(a) that the more prominent purpose of acquisition of the land was logging and not the planting of oil palm;

(b) that the sale of timber rights by the appellant was not a sale of its capital assets;

(c) that what the appellant sold were logs and not the right to extract timber; and

(d) that the sale only took place after the timber was severed.

In the alternative, the appellant contended that the Judge had erred in law in not allowing the RM500,000 paid to the Sultan as exclusively in the production of the income of RM540,000.

Held:

[1] (i) As to ground (a) there is no merit in the appellant's contention that the learned Judge erred in law when he held that the more prominent purpose of acquisition of the land was logging and not the planting of oil palms. What the learned Judge said should not be read in isolation but in the context of his assessment of the Special Commissioners' conclusion as to the purpose of the appellant's acquisition of the land. There is therefore no reason to say that there was error either in law or fact.

(ii) In any event it is not the function of an appeal Court to substitute its conclusions of fact for those of the Special Commissioner, whose duty it is to determine the facts unless the Appeal Court is satisfied that they were wrong.

[2] Grounds (b), (c) and (d) show no substance to warrant any interference with the decision. The Commissioners had rightly proceeded to determine what essentially was a question of fact and upon such premises formed a conclusion of law, and unless the Commissioners' finding is perverse and is not supported by evidence, the Court is reluctant to interfere with it. There was no point of law raised at all but rather the appeal before the learned Judge concerned the application of existing principles to particular facts as found by the Special Commissioners.

[3] As to the final ground submitted by the appellant, it was essentially a question of law which entails the construction of s. 39(1) (g) of the Income Tax Act 1967 which provides that sums paid for the use of the licence or permit to extract timber should not be allowed as tax deductions. The payment of RM500,000/- made by the appellant was for the use of a licence or permit to extract timber and fell within the meaning of sub-s. 1(g) of s. 39 and therefore was not deductible.

[Appeal dismissed with costs.]

Cases referred to:

Kauri Timber Co.Ltd. v. Commissioner of Taxes [1913] AC 77
River Estates Sdn. Bhd. v. Director General of Inland Revenue [1981] 1 MLJ 99
Evans v. The Deputy Federal Commissioner of Taxation for South Australia [1936] 55 CLR 80
James Jones & Sons. Limited v. Earl of Tankerville [1909] 2 Ch D 440
Whitfords Beach Pty. Ltd. v. Federal Commissioner of Taxation [1979-80] 28 Australian LR 637
Director-General of Inland Revenue v. Lahad Datu Timber Sdn. Bhd. [1978] 1 MLJ 203
Director-General of Inland Revenue v. LTS [1974] 1 MLJ 187

Legislation referred to:

Income Tax Act 1967, s. 39(1)(g)

For the appellant - J. Puthucheary; M/s. Skrine & Co.
For the respondent - Mokhtar bin Haji Sidin, (Jamil Hajar, FC with him); SFC

JUDGMENT

Abdul Hamid Omar FJ:

The appellant is a trading company incorporated as a public company in 1968 with the objects, *inter alia,* to carry on business of planters of agricultural produce, cultivators ... buyers of rubber ... and to work and deal with ... timber and so forth.

An associate of the appellant company called NS Oil Palm Bhd. (we shall call NS Oil), agreed on 5 March 1973 (we call 1st agreement) to purchase a piece of land of about 10,000 acres in Keratong area Pahang from the late Sultan of Pahang. The land was on a 99 year lease. One of the restrictive conditions was that the land could not be charged, sold or transferred or be subject to any dealings without the permission of the Authority of Pahang Government.

NS Oil entered into a supplementary agreement (we call 2nd agreement) on 11 June 1973 whereby it was agreed that the land in question would be transferred directly to the appellant on issue of title deed by the Government.

On 12 January 1975 an agreement (we call 3rd agreement) was entered into between DYMM Tengku Ahmad Shah, as successor of Pahang Sultanate and the appellant. The 1st party agreed to perform the terms and obligations imposed on his late father by the 1st and 2nd agreements. He undertook to obtain from the State Forest Officer Pahang a KSK (Kawasan Sudah Kerja) licence covering an area of 6,976 acres. He also undertook to obtain a licence for the remaining area (3,024 acres) of virgin jungle land to enable the appellant to carry out extraction of timber logs therefrom within a period of 2-3 years.

Under the three agreements the appellant purchased 15,000 acres of jungle land with valuable timber for a total consideration of RM1,800,000 and the appellant became registered owner on 2 July 1976.

The 1st agreement was signed by both the late Sultan and his son Tengku Ibrahim on the one part and the NS Oil on the other part. Tengku Ibrahim was a signatory to the agreement because the late Sultan on receiving alienation from the Government by an agreement dated 11 November 1968 transferred all rights and interests in respect of 7,000 acres to Tengku Ibrahim retaining for himself 3,000. Tengku Ibrahim carried on logging operations and by the time the 1st agreement was entered into the total area he had worked was 6,976 acres. The 1st agreement required Tengku Ibrahim to stop logging forthwith. He was however given the right to remove logs felled prior to the date of the agreement.

The 2nd agreement was entered into 3 months after the 1st agreement, also between the same parties.

Under the 3rd agreement the appellant acted as principal purchaser, on whose behalf and for whose benefits the 1st and 2nd agreements were entered into by NS Oil. In this agreement the present Sultan agreed to comply with the earlier agreements and to facilitate in the issuing of two forest licences (a) the KSK licence in respect of 6,976 acres to enable the appellant to carry out extraction of logs and to retain the proceeds of sale and (b) another licence in respect of 3,024 acres of virgin forest also to enable the appellant to extract logs in the area over a period of 2 or 3 years.

Forest licence was never issued to the appellant. In respect of 6,976 acres licence was issued on 1 July 1975 in the name of the present Sultan. The appellant did not itself extract the logs but sold them for a sum of RM540,000 to Koh Tong Leong Sdn. Bhd. under a sale agreement signed on 16 June 1975. All the logs in the area were to be cut and removed from the area at the expense of Koh Tong Leong the buyer.

Qualified Title for the land, an area of approximately 10,000 acres, was issued to the present Sultan and Tengku Abdullah as representatives on 2 July 1976 on a 99 year lease with effect from 19 April 1976 subject to the following express conditions:

(1) Tanah yang diberi milik ini ialah semata-mata untuk tanaman kelapa sawit.

(2) Pokok-pokok kelapa sawit hendaklah ditanam diatas tanah yang diberi milik ini menurut jadual yang telah diluluskan dalam Rompin: 3363 dan mestilah kemudiannya dipelihara dengan memberi puas hati Pegawai Pertanian Negeri, Pahang.

(3) Segala kayu-kayu yang berharga diatas tanah yang diberi milik ini mestilah dikeluarkan terlebih dahulu mengikut jadual, yang telah ditetapkan dan dengan kebenaran bertulis daripada Pegawai Hutan Negeri, Pahang.

These briefly are the essential facts and they are largely not in dispute.

The appellant was assessed with income tax in respect of RM540,000 proceeds of the sale of timber logs in the 6,976 KSK area. On appeal before the Special Commissioners, they found the dominant purpose of the appellant's purchases of land was to sell timber and to plant oil palms. They held that the proceeds of sale of timber are gains derived from an adventure in the nature of trade and thus assessable.

It was the conclusion of the Special Commissioners that the sale of timber logs to Koh Tong Leong was a business transaction and as such the appellant was carrying on a concern in the nature of trade.

The learned Judge accepted the Special Commissioners finding and it was his view that, and we quote: "The appellant's agreement with Koh Tong Leong created an instant obligation upon the latter to cut down and remove the timber within a specified date. There is a duty of instant removal. Therefore the right sold is not an interest in, and possession of, land, to use the words of Lord Shaw of Dunfermline in *Kauri Timber Co. Ltd. v. Commissioner of Taxes* [1913] AC 771. He rejected the appellant's contention that what was sold was not logs but proprietary rights in timber, a sort of interest in, and possession of land.

The learned Judge also rejected the appellant's contention that the timber sold was capital assets. He formed the view that the main point here is the purpose of acquisition. The learned Judge found that ever since the first agreement took place on 5 March 1973, the appellant was interested in the timber and that itself intended to operate the logging operations. He further found that the logging operations were uppermost in the minds of the appellant and more prominent purpose than planting oil palms.

The appeal before us is founded upon the grounds that the learned Judge erred in law in holding:

(a) that the more prominent purpose of acquisition of the land was logging and not the planting of oil palm;

(b) that the sale of timber rights by the appellant was not a sale of its capital assets;

(c) that what the appellant sold were logs and not the right to extract timber; and

(d) that the sale only took place after the timber was severed.

In the alternate it is the appellant's contention that the Judge erred in law in not allowing RM500,000 paid to the Sultan of Pahang as exclusively in the production of the income of RM540,000.

In the course of the judgment the learned Judge made certain observations which we think are pertinent and with which we respectfully agree, in particular when he said that the facts in those cases cited to him are not identical with those in the present case and that the present case concerns essentially the application of existing principles to particular facts as found by the Special Commissioners.

Mr. Puthucheary Counsel for the appellant referred to the first, second and third agreements and submitted that Clause 7 in the 1st agreement refers to the extraction of timber. There is no reference whatever to logging in the 2nd agreement. As for the 3rd agreement, although it deals mainly with matters related to timber operations, it is argued that whether logging or not licence is required to remove timber. It is also argued that timber is only ancillary to the planting of oil palm. One may have many ancillary purposes but the Court should only be concerned with dominant purpose and selling timber was not a dominant purpose.

Outlining the principles deduced from the cases cited to him, the learned Judge succinctly stated that

> A number of cases were cited to me by Counsel for the appellant in support of his submission. Whilst a number of principles can be deduced from these cases, no serious attempts were made to show how and why the finding by the Special Commissioners is wrong. Facts in those cited cases are not identical with those in the present appeal. This appeal certainly raises no point in law at all, but rather concerns the application of existing principles to particular facts as found by the Special Commissioners. Unless it is shown that their finding is perverse and unsupported by evidence, the Court is reluctant to interfere with it.
>
> As a matter of principle any gain received from the sale of assets is not assessable, if the transaction out of which the gain is derived is not an adventure in the nature of trade. Such gain is known as capital gain or capital receipt and the assets disposed of known as capital and the sale transaction for which the receipt is obtained is referred to as a capital transaction or disposal of assets. On the other hand a gain is assessable if the transaction in which the assets are sold is an adventure in the nature of trade. In this circumstance the gain is called the revenue receipt or income, the assets sold known as stock-in-trade, and the transaction as business or an adventure in the nature of trade. Further in order to determine whether a gain in question is a capital receipt or revenue receipt, it is necessary to examine the nature of the assets and the transactions relating thereto and in particular the circumstances of its acquisition and sale, the objects for which the appellant is incorporated and the nature of business carried on by it and the activities of the appellant as regards the assets in question. A number of cases were decided on the intention and purpose of acquisition of the assets. Thus where the assets were acquired not for investment but for the purpose of business of the taxpayer, the gain derived from the subsequent sale is not a capital gain, but a revenue receipt and therefore taxable. For this purpose the determination of the taxpayer's business and purpose of acquisition and sale of assets is therefore essential.

We now turn to the grounds of appeal relied upon by the appellant. The first ground is essentially a question of fact. Salleh Abas FJ examined in great detail the facts found by the Special Commissioners to determine whether they were correct in concluding that the purpose of the appellant acquiring the land was to sell timber logs and to plant oil palms. We do not think there is merit in the appellant's contention that the learned Judge erred in law when he held that the more prominent purpose of acquisition of the land was logging and not the planting of oil palms. What the learned Judge said should not, we think, be read in isolation but in the context of his assessment of the Special Commissioners' conclusion as to the purpose of the appellant's acquisition of the land. What the learned Judge did say after a review of the evidence, particularly in the light of the four facts which formed the basis of the Special Commissioners' findings, was that "logging operations were uppermost in the minds of the appellant and more prominent purpose than planting of oil palm." We see nothing wrong in that, indeed, we are by no means satisfied that he came to an erroneous conclusion. He neither introduced anything new nor made any finding inconsistent with or contradictory to any finding of fact of the Special Commissioners. There is therefore no reason whatever for us to say that there was error either in law or fact.

Counsel for the appellant cited a number of authorities to us, one of them is the *River Estates Sdn. Bhd. v. Director-General of Inland Revenue* [1981] 1 MLJ 99. The facts in that case are entirely different from the facts of the present case. The question that arose for consideration there was whether the appellant company's timber and plantation operations constituted a single integral business or two distinct sources or businesses. The appellant company's principal objects, *inter alia,* were the acquisition of any rubber, coffee, cocoa, coconuts or other plantations and the carrying out of the business of planters, growers and manufactures of rubber and so forth. The facts revealed that the appellant company was carrying on plantation operations in some estates and timber operations in other estates. It was held in that case that "the company carried out two main categories of business namely plantation activities and timber operations and there were therefore two separate businesses deriving income from the five estates or sources." In consideration we see no substance in the appellant's argument that the conclusion arrived at by the Special Commissioners were not warranted by the evidence or that the Commissioners had no evidence to infer that the land purchased was for selling timber and for planting oil palm. In any event it is not the function of an appeal Court to substitute its conclusions of fact for those of the Special Commissioners whose duty it is to determine the facts unless we are satisfied that they are wrong.

Counsel urged us, to accept the appellant's contention that one may have ancillary purposes. He submitted that what the Court should be concerned with is the dominant purpose and in the instant case the selling of timber was not a dominant purpose. *Evans v. The Deputy Commissioner of Taxation for South Australia* [1936] 55 CLR 80 was cited in support of the appellant's contention. We however fail to see how this case could be relevant to the issues before us, particularly in the light of the Special Commissioners' finding that the purpose of the appellant's purchase of land was to sell timber logs and for planting of oil palm and of their conclusion of law upon such finding that the process of sale of timber were gains derived from an adventure in the nature of trade or as the learned Judge described it and we quote "the gain derived from the transaction is not a capital receipt but a revenue receipt." Hence the taxation.

Grounds (b), (c) and (d) may conveniently be dealt with together. What we have stated earlier would also be relevant to our consideration of these grounds. In a nutshell, the appellant's contention is that what is of distinctive importance is that the appellant purchased land and all on land (i.e. timber) and this was capital assets, and when the appellant sold the rights to extract timber, these were rights to go into the land to extract commercial timber. Such rights were incidence of ownership as they did not buy timber separately but instead they bought land and by so doing the appellant had the right to dispose or to sell timber and cannot therefore be said to be an adventure in the nature of trade. It is argued that the Commissioners should have determined that the right passed.

We must first of all stress that the Commissioners proceeded rightly to determine what essentially was a question of fact and upon such premises formed a conclusion of law. Salleh Abas FJ quite rightly said that unless the Commissioners' finding is perverse and is not supported by evidence, the Court is reluctant to interfere with it. Quite appropriately the learned Judge observed that the appeal before him raised no point of law at all but rather concerned the application of existing principles to particular facts as found by the Special Commissioners.

Cases have been cited to us to support the appellant's contention. The learned Judge in the Court below referred to *Kauri's* case, *supra*.

The facts of that case clearly reveal a distinction that can be drawn viewed in the light of the Special Commissioners' finding, endorsed by the learned Judge, that the right sold was not an interest in and possession of land. The right sold by the appellant indeed that which was acquired by Koh Tong Leong was the right of a buyer of such logs he could fell or sever and remove within a specified period for a total consideration of RM540,000 to be paid progressively according to agreed schedule of payment. There was no question of any lease of the area to the buyer and no question of possession of the land not even proprietary rights in timber which can be described as a sort of interest in and possession of land. It was plain and simple a sale of timber transaction which was in fact an adventure in the nature of trade. There was therefore no question of a disposal of any part or at all of capital assets. And consequently the question of proceeds being capital receipt cannot arise.

James Jones & Sons Ltd. v. Earl of Tankerville [1909] 2 Ch D 440 cited to us in support of the appellant's proposition that the right disposed of was that in the nature of land is certainly not borne out by the facts of that case and, for importantly, by the issues that arose for consideration therein. The reference to "legal property" seems to have no bearing whatsoever to any legal or proprietary right in the nature of interest in and possession of land.

It may perhaps be pertinent to refer to the case of *Whitfords Beach Pty. Ltd. v. Federal Commissioner of Taxation* [1979-80] 28 Australian LR 637 a judgment of the Federal Court of Australia where in the course of the judgment Brennan J at p. 644/5, speaking of "business" said that "business in the relevant sense of necessity involves the earning of or the intention to earn profits." He pointed out with reference to *White's* case as follows:

> In that case, the proceeds of the sale of timber growing on land acquired as a capital asset were held to be taxable because the owner committed the land to a business of timber production and sale in which he was engaged (see *White's* case *supra* at 120 CLR 209, 210, 216, 223; 10 AITR 649, 650, 712, 716). The land became devoted exclusively and indefinitely to the sale of standing timber as it stood from time to time (at 223; 716). In *White's* case, the sale and harvesting of a stand of timber left the land on which it stood

available for growing new timber, and the sales of timber in the course of carrying on the business did not exhaust the capital asset ventured in it. The capital asset was by nature regenerating, yielding its produce for sale in a continuing business. In the present case, however, the moneys which are said to bear the character of income are the proceeds of the sale of the taxpayer's land itself, not of its severable produce.

For reasons that we have stated it is our judgment that these grounds show no substance to warrant our interference.

We now turn to the final ground submitted by the appellant. It is essentially a question of law which entails the construction of s. 39(1)(g) Income Tax Act 1967. The issue arises in connection with the sum of RM500,000 paid for licence under the 2nd and 3rd agreements. It is the respondent's contention that the appellant has not shown how this sum should be allowed. In any event it is pointed out that the payment was not made for production of income. Section 39(1)(g) reads:

> 39(1) subject to any express provision of this Act, in ascertaining the adjusted income of any person from any source for the basis period for a year of assessment no deduction from that gross income from that source for that period shall be allowed in respect of:
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> ...
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> (g) any sum, by whatever name called, payable (otherwise than to a State Government) or with the approval of the Minister, a statutory authority, or other body the capital or fund of which is wholly or substantially owned by a State Government or a statutory authority for the use of a licence or permit to extract timber from a forest in Malaysia;

The effect of s. 39(1)(g) was considered in the case of *Director-General of Inland Revenue v. Lahad Datu Timber Sdn. Bhd.* [1978] 1 MLJ 203 where it is shown that sums paid for the use of the licence or permit to extract timber within the meaning of s. 39(1)(g) should not be allowed as deductions. Reference was made to *Director-General of Inland Revenue v. LTS* [1974] 1 MLJ 187 where it is held that this section is to be construed to mean that sums paid by the taxpayer to permit holders is caught by subsection (1)(g) of s. 39 and is therefore not deductable.

See also the case of *Lahad Datu Timber Sendirian Berhad v. Director-General of Inland Revenue* [1981] 2 MLJ 97 where Lord Russell of Killowen delivering the judgment of the board had this to say at p. 6:

> The second question is whether the three items disallowed as deductions by the Special Commissioners come within s. 39(1)(g) of the Act 53. They have already been described. They appear to their Lordships to fall squarely within the description of sums payable for the use of a licence or permit to extract timber, within that statutory provision.

Our view of the present case is that the appellant cannot successfully argue that such sum was not payment for the use of a licence or permit to extract timber within the meaning of s. 39(1)(g) of the Income Tax Act 1967.

For these reasons, we dismiss the appeal with costs.

Also found at [1981] CLJ 166